AN ADDRESS

BY

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Outlining the position of the railroads in the matter of
application by the Eastern Railroads to the
Interstate Commerce Commission
for a general increase of
five per cent. in
freight rates

In the summer of 1910 the railroads operating within what is known as official classification territory—which may be roughly described as that part of the United States lying east of the Mississippi and north of the Ohio and Potomac Rivers—filed with the Interstate Commerce Commission new tariffs which provided for an increase of certain freight rates, chiefly those known as class rates, and the advance so proposed varied from 8 to 20 per cent.

At the request of the Commission the new tariffs were suspended, and a hearing was ordered at which the railroads were given opportunity to present their case and those opposed equal opportunity to present theirs. The railroads based their claims chiefly upon the argument that their expenses had been greatly increased by higher wage schedules recently granted to their employes, but they also called attention to the fact that taxes had increased largely within recent years, and that legislation enacted during the same period—both State and Federal—had also very considerably increased the cost of operation—all of which so narrowed the margin between income and outgo that unless they were permitted in some manner to increase their revenue, the net earnings of the future would not be sufficient to enable them to maintain the properties in a satisfactory condition, or provide such improvements and additions as the growing commerce of the country constantly demanded. The Commission took the case under consideration and in its report dated February 22nd, 1911, in which it reviewed in a careful and able manner the whole question, announced its decision withholding its approval of the new tariffs, and ordering that the rates in effect at that time should be continued.

A careful reading of the report known as I. C. C. No. 3400 discloses—first, that the railroads failed to establish in the minds of the Commission, a necessity for increased

revenue; second, it was suggested that even though a necessity had been established, it was doubtful if the plan proposed was the right or best way in which to obtain such revenue; third, it was further pointed out that there was a general depression of business at that time, and that the carriers ought not to expect to raise their rates when business was dull. However, the Commission also said, in effect, that should it come about that their views were not sustained by future developments, and should it appear at any time that there was a real necessity on the part of the carriers for increased revenue, in order that they might be in position to provide such facilities as the public required, that they would, upon request, give the matter further consideration. They said that they would not hesitate, under such circumstances, to authorize such rates as would be reasonable.

During the first two years immediately following the decision, the commerce of the country showed little, if any, increase, but during the present fiscal year, there has been a marked activity in business of all kinds, and the gross earnings of the railroads generally for the year ending June 30, 1913, will probably be the largest in their history. It might be supposed from this, and as a matter of fact, it has been urged in some quarters that the railroads should now be able because of increased earnings to show sufficient surplus above interest and dividend requirements to justify such further capital expenditures as may be necessary. I shall undertake to show that such is not the case.

First of all, the rates which were in effect in 1910 have not in the aggregate been maintained—that is to say, while certain increases have been made during that period, decreases have also come about. The net result has been, for example, a reduction in the earnings of the Baltimore & Ohio Company on the freight business

handled by that company in October, 1912, of more than $100,000 when compared with what they would have been in October, 1909. In other words, if the same rates, classifications and conditions had been in effect in 1912 that were in effect in 1909, the Baltimore & Ohio Railroad Company would have received in October, 1912, $100,000 more than it did receive for the business actually handled in that month, and it is estimated that for the year, such decreases would amount to not less than $800,000.

I mention the Baltimore & Ohio figures because I happen to have them in mind, and because I believe that conditions on that road are not unlike what they are on the other roads in similar territory.

Not only has the general basis of rates, as I have shown, been lowered to some extent by orders of the regulating commissions, and perhaps, to an equal or greater extent by commercial conditions or influences which are beyond the power of the carriers to resist—but during the same period expenses have also very greatly increased, as I will endeavor to show.

Again in the case of the Baltimore & Ohio, the wage increase of 1910 amounted to approximately $2,500,000 per year, and the increases which have been granted—either voluntarily or by virtue of arbitration awards—within the last twelve months have resulted in adding over $800,000 more to our expenses each year. Further, as is well known, the conductors and trainmen are now engaged in taking a strike vote for the purpose of enforcing their demands for an advance of approximately 17 per cent., and while it is not likely that they will obtain all they ask for, it is probable that if the matter should go to arbitration under the provisions of the Erdman Act as it now stands, that they would receive a substantial increase.

Prices of various kinds of material have also advanced

since 1910. The coal bill of the Baltimore & Ohio Railroad Company amounts to approximately $6,000,000 per year, and within the last two years there has been an advance in the price of coal of upward of 10 per cent. The increase in price of ties has also been considerable. Prices asked and paid for locomotives, freight and passenger cars are also higher today than was the case three years ago for equipment of the same kind.

Legislation of various kinds—both state and federal—has had an important influence upon expenses. The so-called Full Crew Bill, which has become a law in many of the States, requires the railroads to employ an extra man on all trains of more than certain length, regardless of the local conditions.

The hours of service law, boiler inspection law, laws in various States prescribing standards of construction for caboose cars, laws with reference to the construction of postal cars, revised orders with reference to safety appliances upon new equipment, as well as upon existing equipment; laws with reference to grade separation, etc., etc.,—all have tended to very greatly increase the cost of operation. It is not my purpose, at this time, to question the wisdom of any of the laws referred to, because regardless of whether they are wise and necessary, the added expense is there and must be paid.

Taxes have increased largely during the last three years. In the case of the Baltimore & Ohio Company, the increase in that one item since 1909, amounts to more than $900,000 a year. I think it is perhaps not a matter of common knowledge, although one of public record, that the American railroads, as a whole, pay each year in taxes more than $120,000,000, a sum nearly two and one-half times as much as the total amount received by all the railroads for carrying the mails.

Another very important element to be considered is the rate of interest which railways are obliged to pay

upon new capital raised for improvements and betterments. It may be said that the interest basis on all investments has been raised within recent years, and that the very best securities must pay higher rates today than ever before, and that the railroads are not peculiar in this respect; but even so, they are still required, in common with others, to pay a much higher rate of interest than was the case some five or ten years ago. Ten years ago, for instance, if a railroad company with well established credit, decided to increase its capital for improvement purposes—we will say $1,000,000—it was customary to assume that the interest charge on that account would be approximately $40,000 per year. Under existing conditions, the interest charge would be between $50,000 and $60,000 per year as a minimum, and in some cases, even in excess of $60,000. This item alone, as you will see, becomes very important when large systems—like the Baltimore & Ohio—are spending upward of $20,000,000 a year, and ought to do so, for betterments, extensions and new equipment made necessary by the growing demands of a constantly expanding commerce.

Further, the public demands, expects and receives a higher standard of service in all directions than has ever been the case before. This results, for instance, in the running of a greater number of passenger trains than the business itself would justify over the lines where the traffic is light; and also in a higher standard of freight service—that is to say, carriers are required to furnish cars more promptly, and to move them with less delay. While no one recognizes better than the railway managers that the service is not always satisfactory, and is frequently not such as they would like to furnish, I believe it is, nevertheless, a fact that upon the whole it is on a more satisfactory basis today than ever before, but this also means greater expense in operation.

The various influences which I have mentioned have

all tended to further reduce the margin between income and outgo, and it has become so narrow that the railroads—many of them, at least—do not feel justified in further increasing their capital account, regardless of the rate at which money may be obtained, because the burden assumed by so doing might seriously interfere with their ability to maintain reasonable payments upon their capital issues already existing.

The Federal Census report of 1910 showed that during the previous decade, capital invested in agriculture had increased 100 per cent, capital invested in manufactures had increased 105 per cent, and capital invested in railroads during the same period had increased only 40 per cent. One result from this disparity of investment was to place the manufacturing industries as a whole, when measured by the amount invested, second only to agriculture, and in the place previously occupied by the railroads, while the railroads in turn drop back from second place to third.

Mr. James J. Hill, in an address delivered in Chicago in 1908, said that he was convinced that the railroads of the country as a whole should spend not less than one billion dollars per year for the next five years for additions and betterments, including, of course, equipment. The published reports of the Interstate Commerce Commission show, however, that during the four years ending June 30, 1908-09-10 and 11, the actual investment in the railroads increased $2,044,000,000, or at the rate of $511,000,000 per year, about one-half of Mr. Hill's estimate. The same reports also show that the net earnings of the railroads for the year ending June 30, 1911, after paying operating expenses and taxes, were actually $8,787,000 less than they were in 1907, and before the additional $2,000,000,000 had been expended, and the per cent. of return on cost of road and equipment in 1911 was only 4.97, as compared with 5.82 in 1907.

With the situation as I have endeavored to show it, clearly in mind, those responsible for the policy and management of the railroads in official classification territory have become seriously concerned regarding the future of the properties, of which they are in charge.

I hardly think it is necessary to take your time for the purpose of endeavoring to show that the railroad is necessary as a means of transportation in a country of magnificent distances, such as the United States. Of course, it is recognized that there can be no such thing as commerce without transportation of some kind, and at the present time the railroad affords the only means of transportation worthy of consideration, so far as the inland traffic of the country generally is concerned, and it is of the utmost importance if industrial development is to continue, that the transportation system as a whole should be adequate to meet the reasonable requirements of the country's commerce at all times.

If I am not mistaken in my understanding of the general situation; and if I have stated it to you as it actually exists, it would seem, that we all must agree that we are confronted with a serious condition, and one worthy of the careful and dispassionate thought of everyone interested in the development of our country. Granting for the sake of argument that the situation is substantially as I have stated, it seemed to me that the most important question next to be considered is—how can the matter be adjusted? and that too, for the best interests of all concerned, including not only the railroad bondholders, shareholders and employes, but also from the standpoint of the manufacturer and consumer, because in the last analysis the consumer is the one who will ultimately pay the freight.

It was suggested in case No. 3400, as I have already shown, that the railroads had not only failed at that time to establish the necessity for increased revenue, but that

the method proposed for the purpose of raising additional revenue was perhaps not the best or fairest under all the circumstances. It was pointed out that the relation of rates which then existed, had come about through a long period of competition and regulation, and that anything which tended to disturb that relationship should be avoided if possible. In light of all that has since transpired, I am personally prepared to admit the force of that suggestion, and my associates are also generally in accord and when it was decided a short time since to take the matter up again with the Interstate Commerce Commission, it seemed best to those who had given the subject much study, that instead of seeking to obtain the necessary revenue by the methods proposed in 1910, it would be better to obtain it, if possible, by a small percentage of advance, uniformly applied to all items. It was believed that in view of all the circumstances the increase should be not less than 10 per cent., but desiring to obtain the necessary relief in a manner which would cause the least possible disturbance of existing commercial conditions, it was concluded to ask permission to make a 5 per cent. advance only, and then should it develop later on that the relief so obtained was not sufficient, the matter could be given further consideration, in view of the then existing conditions.

It has been suggested that if the railroads need additional revenue, they ought, before making any general advance, to raise certain rates now in effect which are quite generally believed to be too low. The carriers recognize the force of that argument, and they hope to be able, as time goes on, with the assistance of the Interstate Commerce Commission and also of the shippers themselves, to bring about, if possible, a more equitable rate adjustment; but a careful review of that question—with particular reference to the business handled by the Baltimore and Ohio Company—shows that even if all

the low rates referred to could be advanced, and that, too, without affecting the amount of business handled, the increased revenue so obtained would be less than half a million dollars, and while of course that amount when considered by itself is a large sum of money, it is not at all adequate for the requirements of the situation.

Further, it should be borne in mind that commissions will continue from time to time to order specific rates reduced, because they are found to be relatively too high, and commercial conditions will also tend to bring about reductions in the future, such as I have shown to have taken place in the last three years.

Three years ago the commission said that the railroads had failed to establish a necessity for increased revenue. I believe that necessity is apparent to all at the present time. It suggested that the plan then proposed was not the right one, and with that suggestion the railroads now agree, and they have proposed another method which seems under all the circumstances to be fair and equitable. It was also suggested that if rates were to be raised at all, it should be done when times were good, and upon the whole business was never better than it is at the present time.

I have used chiefly in support of my arguments, figures referring specifically to the Baltimore & Ohio Railroad. I have done this because I am naturally more familiar with the affairs of that company than with the railroads as a whole in the territory involved, but I think it can safely be said that the Baltimore & Ohio Company is typical of the situation. There are doubtless some railroads interested in this present move which do not need, at this time, such an increase of revenue as might come from the proposed advance in rates, and there are doubtless others which should have a much greater increase than the one proposed, and in that connection it may be

recalled that Commissioner Prouty in discussing the New York Central, Pennsylvania and Baltimore & Ohio Companies in case No. 3400, used the following words:

> "Under rates reasonable for these three systems there may be lines whose earnings will be extravagant, but that is their good fortune. There may be lines which can not make sufficient earnings, but that is their misfortune. We out not to impose upon this territory, for the purpose of allowing these defendants additional revenues, higher rates than are adequate to these three systems considered as a whole."

It is believed that the increased rates proposed are fair and reasonable when considered in connection with the operations and requirements of the three railroads specifically referred to by the Commission, and it is urged that if they are reasonable when so considered, they ought not to be withheld simply because they might result in greater earnings on the part of some other carrier, than would be justified, when considered of and by itself.

I wish to say just a word with reference to the general railroad situation. There can no longer be any doubt that the public has ample and efficient machinery for the thorough control and regulation of the railroads. We have not only a Federal Commission in Washington which has been granted the widest possible powers to regulate and supervise, but we have also commissions in nearly all of the individual States, with powers relatively as great as those delegated to the Federal body. The Interstate Commerce Commission is empowered to prescribe the manner in which the railroad accounts shall be kept, even to the minutest detail, and the roads are now keeping their accounts in harmony with the requirements of the Commission. It is also provided by law, under penalty of heavy fine and imprisonment, that no discrimination shall be shown either with reference to rates paid or service given, as between individuals or communities.

It has come to be understood that the railroad is a semi-public institution, and that it is expected to treat, and must treat, all with equal fairness. The executives in charge of the railways by virtue of what has come about, occupy the dual position of semi-public officers, charged with the duty of operating the properties in harmony with the laws of the country, and also with the equally important duty of trustee, representing those whose money is invested in the enterprise. It should be remembered that although the railroad is considered a public utility with important public functions to perform, it nevertheless owes its very existence to the employment of private capital, and Mr. Commissioner Prouty has well said in one of his public addresses that "we can provide by legislation the sort of cars which a railroad shall use, and the rates which it shall impose; we cannot by legislation force one single dollar of private capital into railroad investment against its will".

Those who to-day manage the railroads are chiefly men who have devoted the greater part of their lives to that service, and will not as a rule be personally affected one way or the other by the outcome of this movement. They appreciate fully their obligations to the public, while at the same time not unmindful of their duty as trustees, and I should personally feel that I had failed absolutely to measure up to the requirements of my position, if I felt as I do about the situation and remained silent. I feel it incumbent upon me as the chief executive of the Baltimore & Ohio Company, to do what I can to bring the situation as I see it clearly before, not only the Commission which in the end will decide the question at issue, but also before those who, like yourselves, are vitally interested in the proper solution of this problem. Should the Commission, however, after a full hearing, decide again against the contention of the carriers, I at least—and I am sure I can speak with equal clearness concerning my associates—shall continue to do the best that I am able to meet the requirements of the situation, but it ought to be clearly

understood that in that event the policy of cheapness instead of quality, which the railroads have already been obliged in a measure to adopt, must of necessity be continued, and I cannot believe that the American people want their railroad system run permanently on that basis.

Before closing, I wish to quote from the language used by Mr. Commissioner Lane, now Secretary of the Interior, in his report given in case known as No. 3500, with reference to this same question. He says, speaking for the Commission:

> "We do not say that the carriers may not increase their income. We trust they may, and confidently believe they will. If the time does come when through changed conditions it may be shown that their fears are realized, or approaching realization, and from a survey of the whole field of operations there is evidence of a movement which makes against the security and lasting value of legitimate investment and an adequate return upon the value of these properties, this Commission will not hesitate to give its sanction to increases which will be reasonable."

Conscious of the statements that are sometimes made concerning the alleged over-capitalization and excessive freight rates of American railroads, I wish to quote again from one who has justly earned his title as empire builder, and who is qualified because of a lifetime experience and a careful study of the whole question to speak with authority. The following quotation is taken from Mr. James J. Hill's book, entitled "Highways of Progress":

> "The American railway pays the highest wages in the world, out of the lowest rates in the world, after having set down to capital account the lowest capitalization per mile of all the great countries of the world."

Of what other great American industry can the same claim be made and successfully defended ?